INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and regulations involved	2
Statement	4
Argument	7
Conclusion	12

CITATIONS

Cases:	
Helvering v. *Coleman-Gilbert*, 296 U. S. 369	7, 10
Helvering v. *Combs*, 296 U. S. 365	7, 8
Morrissey v. *Commissioner*, 296 U. S. 344	7, 10, 11, 12
Swanson v. *Commissioner*, 296 U. S. 362	7, 10
Statute:	
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 701 (U. S. C., Title 26, Sec. 1696)	2
Miscellaneous:	
Treasury Regulations 74:	
Art. 1312	2
Art. 1314	3

130587—37

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 743

A. A. LEWIS AND COMPANY, MAIN AND LINCOLN AVENUE SUBDIVISION, TRUST NO. 1523, CENTRAL REPUBLIC TRUST COMPANY, FORMERLY NAMED CENTRAL REPUBLIC BANK AND TRUST COMPANY, AS SUCCESSOR TRUSTEE BY CONSOLIDATION, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 36–38) is unreported. The Circuit Court of Appeals reversed the decision of the Board without written opinion (R. 53).

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 18, 1936 (R. 53). The petition for a writ of certiorari was filed February 18, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust in question is an "association" within the meaning of Section 701 (a) (2) of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The Revenue Act of 1928, c. 852, 45 Stat. 791, provides in part as follows:

> SEC. 701. DEFINITIONS.
>
> (a) When used in this Act—
>
> * * * * *
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies. (U. S. C., Title 26, Sec. 1696.)
>
> * * * * * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 1312. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws,

agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 701.

ART. 1314. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by sections 161–170 and by articles 861–891. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 701. Even in the absence of any control by the beneficiaries, where the trustees are not re-

stricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the Act.

STATEMENT

The facts may be summarized as follows (R. 8–38):

On December 12, 1925, one Minerva S. Melidones was the owner of certain undeveloped real estate, and on that date, for the purpose of subdividing and selling the same, she entered into two written agreements affecting the property (R. 36). One of the agreements, designated "Declaration of Trust", provided for the placing of title in the Chicago Trust Company (predecessor of Central Republic Trust Company) as trustee for the ultimate use and benefit of herself and one A. A. Lewis, as beneficiaries. The trust so created was known as Trust Number 1523. (R. 13–36.)

The pertinent provisions of the trust instrument may be summarized as follows: That the trustee will hold the property and the proceeds, profits, and avails thereof for the use and benefit of the beneficiaries; that it is agreed among the parties and by any persons who may become entitled to any interest under the trust that the interests of the beneficiaries shall consist solely of a power of

direction to deal with the title to the property and the right to receive the proceeds from rentals or from sales; that such right in the avails of the property shall be deemed to be personal property and may be assigned and transferred as such; that it was the intention of the parties to vest full legal and equitable title in the trustee; that the trustee is sole owner of the property, and so far as the public is concerned has full power to deal with it, but that it is understood and agreed by the parties and any persons who may hereafter become parties to the agreement that the trustee in dealing with the title to the property will follow the directions of the trust manager or such persons as may be beneficiaries at the time; that transferable certificates evidencing the interests of the beneficiaries may be issued by the trustee, and that thereafter valid assignments of beneficial interests may only be had by surrender of old certificates of interest to the trustee and issuance of new certificates in exchange by the trustee; that if any property remains in the trust twenty years from date, it shall be sold at public sale by the trustee and the proceeds divided among the beneficiaries, and that the trustee was entitled to reasonable compensation for any special services rendered it or for taking and holding any other property thereafter deeded to it. (R. 13–17.)

Under an agreement which was attached to the trust instrument and which was executed by the

beneficiaries and the trustee, Lewis was appointed "manager of the trust" and was granted "such powers and duties in connection with the administration of said trust as may be necessary to facilitate the sale of said land." (R. 22–23.) The agreement was made irrevocable for a defined period (R. 22), and Lewis was given a specific interest in all sales contracts (R. 32). Among the powers specifically delegated were the following: To exercise management and control of the trust property for the purpose of selling it; to employ, at his own expense, a sales organization; to select and approve purchasers for the lots, both as to character and financial responsibility, and to enter into contracts with the purchasers in the name of the trust as "manager" of said trust; to request the trustee to execute deeds and other necessary instruments. The trustee agreed to convey title to purchasers of lots upon the written direction of Lewis. (R. 17–36, 37.)

The agreement provided that it should not be construed as creating a partnership, and that it should not be placed of record. (R. 33.)

The Board of Tax Appeals held that the trust was not an association within the meaning of Section 701 (a) (2) of the Revenue Act of 1928. (R. 36–38.) This action was reversed by the Circuit Court of Appeals, on the authority of *Morrissey* v. *Commissioner*, 296 U. S. 344, which had been decided subsequent to the decision of the Board of Tax Appeals. (R. 53.)

ARGUMENT

The sole question presented herein is whether the trust in question is an "association" within the meaning of Section 701 (a) (2) of the Revenue Act of 1928, *supra*, p. 2, and hence is to be taxed as a corporation. That section defines a corporation as including "associations, joint-stock companies, and insurance companies," but the term "association" is not defined.

The question of what constitutes an "association" within the meaning of the various revenue acts has now been definitely settled by the opinions of this Court in *Morrissey* v. *Commissioner*, 296 U. S. 344; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369; *Helvering* v. *Combs*, 296 U. S. 365; and *Swanson* v. *Commissioner*, 296 U. S. 362. In the *Morrissey* case, this Court said in part (pp. 358, 360):

> While the use of corporate forms may furnish persuasive evidence of the existence of an association, the absence of particular forms, or of the usual terminology of corporations, cannot be regarded as decisive. Thus an association may not have "directors" or "officers", but the "trustees" may function "in much the same manner as the directors in a corporation" for the purpose of carrying on the enterprise. The regulatory provisions of the trust instrument may take the place of "by-laws." * * *
>
> * * * * *
>
> Applying these principles to the instant case, we are of the opinion that the trust

> constituted an association. The trust was created for the development of a tract of land through the construction and operation of golf courses, club houses, etc. and the conduct of incidental businesses, with broad powers for the purchase, operation and sale of properties. Provision was made for the issue of shares of beneficial interests, with described rights and priorities. There were to be preferred shares of the value of $100 each and common shares of no par value. Thus those who took beneficial interests became shareholders in the common undertaking to be conducted for their profit according to the terms of the arrangement. They were not the less associated in that undertaking because the arrangement vested the management and control in the trustees. *And the contemplated development of the tract of land held at the outset, even if other properties were not acquired, involved what was essentially a business enterprise. The arrangement provided for centralized control, continuity, and limited liability, and the analogy to corporate organization was carried still further by the provision for the issue of transferable certificates.* [Italics supplied.]

And in the *Combs* case it was said (pp. 368–369):

> The parties joined in a common enterprise for the transaction of business, and the beneficiaries who contributed money for that purpose became associated in the enterprise according to the terms of the arrangement.

> The essential features of the enterprise were not affected by the fact that the parties confined their operations to one oil well. See *Swanson* v. *Commissioner, ante,* p. 362. Parties may form an association for a small business as well as for a large one. Here, through the medium of a trust the parties secured centralized management of their enterprise, and its continuity during the trust term without termination or interruption by death or changes in the ownership of interests, and with limited liability and transferable beneficial interests evidenced by certificates. Entering into a joint undertaking they avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain to corporate organization. The fact that meetings were not held or that particular forms of corporate procedure were absent is not controlling.

The facts in the instant case bring it squarely within the rules enunciated by this Court in the above cases. The business enterprise here was to sell and rent lots in a real estate subdivision for a profit (R. 15–16, 19). Administrative control was effectively centered in Lewis. He managed and controlled the trust property for the purpose of carrying on the business. (R. 22–23.) The beneficiaries reserved a power to direct the disposition of the trust property (R. 15), subject, of course, to the irrevocable period of the agreement with

Lewis (R. 22). Such reservation of power in the beneficiaries makes even clearer the existence of an "association". Cf. *Morrissey* v. *Commissioner*, 296 U. S. 344, 349–354.

A provision was made for continuity in the office of trustee (R. 34), and was availed of at least once. (R. 4, 9). The interests of the beneficiaries to receive the proceeds from rentals or sales were made personal property and assignable as such (R. 14). It was contemplated that others might join in the enterprise (R. 13, 15). Indeed, the trust agreement provided for the issuance of transferable certificates "to evidence the interests of the beneficiaries", which were, in effect, to be transferred on the books of the trustee (R. 14). Continuity of existence was thus carefully provided for, although the venture did not prosper (R. 3, 6, 7), and, so far as it appears from the record, no certificates of participation were issued (R. 9). However, under recent decisions of this Court, it is immaterial that there may never have been more than three parties (Lewis, one other beneficiary, and the trustee) interested in the business at any one time. *Swanson* v. *Commissioner*, 296 U. S. 362, 365; *Helvering* v. *Coleman-Gilbert*, 296 U. S. 369, 372, 373–374.

Sole ownership of the property was in the trustee and, so far as the public was concerned, he had full power to deal with it (R. 15). The sole right to possession of the trust property was in Lewis, the manager of the trust (R. 26). The benefici-

aries recognized that certain payments and expenses must be borne should they desire the trustee and Lewis to continue the business (R. 14–15, 16, 31), but no liability on the part of the beneficiaries to the general public was recognized. It was specifically provided that the agreement between Melidones, the original owner of the property, Lewis, and the trustee should not be construed as creating a partnership, and should not be placed of record (R. 33). The trust set-up as set forth immunized the general fortunes of the trustee and the beneficiaries from general liability to the public. See *Morrissey* v. *Commissioner*, 296 U. S. 344, 359.

Thus the trust device of the parties here secured for this enterprise the substantial corporate advantages of centralized management, continuity and limited liability. Every test as laid down by this Court in the recent cases cited (p. 7, *supra*) is met. We do not believe that under the rules enunciated in those cases, it is material to determine whether the trust here, or the trusts there found to be "associations", were technically "Massachusetts Business Trusts." There are, of course, immaterial differences between the trust agreement here and the trust agreements involved in the *Morrissey* case and its companion cases (p. 7, *supra*), but, as this Court has recognized, "it is impossible in the nature of things to translate the statutory concept of 'association' into a particu-

larity of detail that would fix the status of every sort of enterprise or organization which ingenuity may create." *Morrissey* v. *Commissioner*, 296 U. S. 344, 356. Viewed in this aspect, no question of unsettled law, important or otherwise, is here presented.

CONCLUSION

The decision below is in harmony with the recent pronouncements of this Court. The question presented has been definitely settled and no conflict of decisions exists. The petition should be denied.

Respectfully submitted.

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